City of Seattle

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Office of Cable Communications

Report on WIN Franchise Application

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Background

Western Integrated Networks (WIN) of Washington submitted to the Office of Cable Communications an application for a cable franchise pursuant to Chapter 21.60 of the Seattle Municipal Code. As required by the franchise ordinance, the application consisted of information about WIN and a proposed franchise agreement, based on the existing agreement with AT&T. Over the past few months City staff and WIN representatives have engaged in negotiations to arrive at a proposed franchise agreement for Council's consideration. An ordinance and copy of the proposed franchise agreement have been referred to the City Council for adoption. The Law Department was involved in all phases of the franchise negotiations and has reviewed the proposed franchise agreement.

Section 21.60.240 of the Municipal Code requires the Office of Cable Communications (OCC) to prepare a written report for City Council on any application for a cable franchise. Section 21.60.260 of the Code suggests the following criteria by which Council should evaluate the relative merits of an applicant for a franchise: the quality of the service proposed; the experience, character, background and financial responsibility of the applicant and its management and owners; the technical and performance quality of the equipment; the program proposed for construction, and the applicant's ability to meet construction and physical requirements and to abide by the terms and requirements of the franchise. In preparing its report the OCC obtained all information from WIN necessary to provide a thorough analysis for Council's review.

This report is structured in six sections: 1) A review of WIN's application for completeness; 2) a description of WIN and its proposed services; 3) a review of WIN's technical, legal and financial qualifications; 4) an outline of the major provisions of the proposed franchise agreement; 5) a review of the effects on the City of granting this franchise including a description of the risks and benefits: and 6) staff conclusions and recommendations.

1. Status of WIN's Application

After a review of the initial application submitted by WIN, staff has on several occasions requested additional information from WIN. WIN has responded to those requests and submitted additional financial and technical information. Staff has verified that WIN has paid the new franchise application fee of $20,000. This office now considers WIN's application to be complete, sufficiently responsive and consistent with all the requirements of the franchise ordinance.

2. Applicant Information

WIN is a startup company with no previous track record in the telecommunications field, but had an experienced management team. Its corporate offices are located in Denver Colorado. The company plans to construct a broadband system capable of offering a package of cable television programming, high speed Internet access, and local and long distance phone service to residential and business customers.

While WIN is a new company, its directors and officers have considerable experience in the field of cable communications. James C. Vaugh, WIN's CEO, has over 35 years of experience in the electronic communications industry. He is the former head of FrontierVision Partners, L.L.P, a cable television company he founded in 1995. When the company was sold in 1999 it had a subscriber base of 700,000. Frank L. Casazza, WIN's President, has 30 years of experience in the telecommunications field. He has held key executive positions with Pacific Bell, Contel, Boeing and Mobex Communications. After a review of the backgrounds of the other Officers and Directors of the company, staff has concluded that WIN's management team has a wealth of expertise in the administrative, financial, technical and engineering facets of the industry.

WIN currently has franchises in Sacramento, San Diego, California and Dallas, Houston, San Antonio and Austin, Texas. In addition to Seattle, WIN has additional franchises pending in Portland Oregon, Los Angeles, San Francisco and Oakland California. In August it began construction of its first network in Sacramento.

3. Technology, Legal, Financial Qualifications

Technology

WIN's technology differs from the hybrid fiber coaxial (HFC) systems currently being deployed by AT&T and Millennium, the two other cable providers in Seattle. In HFC systems, providers run fiber optic cable from an area hub to a neighborhood node. At the node, optical signals are converted into electrical signals that can be carried over the coaxial cable that runs from the node to the customer premises. While WIN will also provide its video programming via an HFC network, it will be the first major cable operator to bring fiber optic cable directly to homes. WIN will use its fiber to the home to provide high speed Internet access and telephone service.

Dedicated fiber connections to the home will allow for higher bandwidth for subscribers. Most customers of an HFC system share available bandwidth on a node, limiting the transmission speeds available during peak usage times. According to WIN, the fiber and lasers in its system will be capable of delivering one hundred megabits per second (100 mbps) symmetric bandwidth. Symmetric means that it will have similar upstream and downstream transmission speeds. Generally consumer broadband services have been designed with a lower upstream bandwidth; symmetric bandwidth may prove important to enhance publishing of information by consumers and certain professional, consumer and educational Internet applications. By way of comparison, the bit rate promised by WIN is more than 65 times faster than typical 1.5 megabits per second cable modem connections offered by most of today's cable operators.

WIN's network will feature a dual-ring fiber transport backbone that will connect a Primary Processing Center to six Primary Hubs. The Primary Processing Center will contain a cable programming head end, telephone and data switching facilities and will serve approximately 800,000 homes. The hubs, each serving approximately 32,000 homes will be connected by fiber rings to remote terminals, each serving approximately 1,000 homes. A dedicated fiber from the remote terminal will deliver IP voice and data traffic to an optical transceiver (a small laser-equipped device for directing telecom traffic) mounted at the side of each subscriber home. WIN has an agreement with Lucent to provide these transceiver devices; however, these are not a production item at this time. Video fiber from the remote terminal will feed neighborhood nodes that will connect to subscriber premises via coaxial cables as in the HFC design. The system is scalable, allowing WIN to expand the capacity of the system as demand increases.

The amount of fiber in the system should result in more bandwidth, greater reliability and better data and voice signal quality. WIN will provide battery and generator backup power supplies to its 40,000 square feet primary processing center. The remote terminals will have standby battery electrical power equipment.

Financial Capability

The Office of Cable Communications contracted with KFA Services, a consulting firm specializing in financial analysis of the cable industry, to analyze WIN's financial capability. WIN provided detailed financial information to KFA Services, including partial financial projections for construction and operation of its broadband system in the City.

To date WIN has received equity commitments of approximately $830 million dollars. About 90% of this commitment come from several investment banks and venture capital firms. The OCC recently received a letter from James Vaughn, WIN CEO, stating that WIN has allocated $200 million of this initial equity commitment to begin the buildout of the Seattle system. A copy of this letter is attached. While WIN has received commitments of $830 million, it has actually received approximately $71 million of these funds. KFA was unable to determine the conditions necessary for WIN to receive the remainder of the commitments.

It is clear that WIN will require substantial amounts of additional capital to complete and operate its system in Seattle. According to documents reviewed by KFA services, WIN will need approximately $395 million through 2005 to construct and equip the system in Seattle. It is expected that additional expenditures, attributable to system and subscriber growth in the City, will occur in subsequent years. Thus total capital expenditures of approximately $492 million are projected through the year 2010.

WIN expects to cover this shortfall by seeking substantial debt financing and by deriving revenues from its Seattle subscribers, once it begins to offer services in the first built out areas. WIN has indicated that it is currently waiting for a better interest rate environment before seeking additional debt financing in the capital markets. There is some risk that the financial markets will not make sufficient capital available for this purpose. The extent to which WIN can generate sufficient revenues from Seattle subscribers is uncertain. It appears that WIN is making optimistic projections about the number of customers it will have in Seattle by 2006. While the offering of bundled cable, telephone service and high-speed Internet access will help, there is no assurance that WIN will be able to generate $178 million from its Seattle subscribers in 2006, as outlined in their projections.

In summary, there are uncertainties about how and when WIN will be able to obtain the additional capital it will need to complete and successfully operate its system in Seattle. We should point out that this is not atypical of the financial status of other competitive cable providers.

Legal Qualifications

In March 2000 WIN registered in the State of Washington as a Limited Liability Company. WIN is also registered with the Washington Utilities and Transportation Commission (WUTC) as a Competitive Local Exchange Carrier (CLEC). It is seeking authority from the City Council to use the right of way to install infrastructure that can provide cable services. WIN does not require a franchise to provide telephone service. As mentioned, WIN will also provide non-cable services like high speed Internet service.

4. Summary of Proposed Franchise Agreement

As part of its application, WIN submitted a proposed franchise based on the existing franchise agreement with AT&T. That draft franchise provided a basis for negotiations between City staff and WIN. Staff has exercised due diligence to ensure that a proposed franchise will be in the best interests of the City and its residents while also allowing WIN an opportunity to compete in Seattle without facing a competitive disadvantage relative to the incumbent cable operators. This section provides a brief summary of some of the substantive provisions of the proposed franchise.

A. Scope and Term

The franchise has a 10-year term. It will cover cable services but not telecommunications services provided by WIN. Although a recent decision by the 9th Circuit Court of Appeals has classified Internet over cable as a telecommunications service, the eventual regulatory framework for Internet over cable is uncertain at this time. The court has deferred to the Federal Communications Commission (FCC), which may soon rule on the regulatory treatment of cable modem service. Notwithstanding this uncertainty, WIN has agreed to a set of City principles regarding its Internet service and has no issue with the City's intent to apply the consumer protection standards of the Cable Customer Bill of Rights (CCBOR) to those services.

B. Franchise Area

Ordinance No. 120138 amended Chapter 21.60 of the Municipal Code, establishing a citywide franchise. WIN has applied for a franchise to serve the entire City. WIN, and other cable operators, may request a waiver from serving a particular section of the City if the Office of Cable Communications has determined that sufficient competition exists in the given areas. For purposes of the franchise, sufficient competition is achieved when a customer has a choice among at least 3 cable operators.

C. PEG Programming, Video Feeds

WIN has agreed to a contribution of up to $.50 per month per subscriber to support Public Access programming (with an initial rate set at $.40 per subscriber). This will allow us to maintain the current commitment of $600,000 a year for public access even if WIN is successful in luring customers away from AT&T. It has agreed to carry PEG channels and to interconnect PEG channels with contiguous franchises in other jurisdictions. WIN will also provide video feeds to up to 15 locations designated by the City and install equipment necessary to transmit signals via the video feeds. It will also give the City a technology grant of $545,000 in six installments to fund the purchase of capital equipment for government access programming. Finally, WIN agreed to carry our government access channel countywide to the extent of their service area.

D. Subscriber Relations

WIN has agreed to establish at least two Subscriber Service Centers in Seattle, opening the first one no later than 12 months after the effective date of the franchise, or by the time it begins operating its system. WIN agrees to all customer service standards contained in the existing AT&T franchise and committed to comply fully with the Cable Customer Bill of Rights.

E. Franchise Fee

The franchise fee will be set at 5% of Gross cable revenues. The City will keep in place the current system of providing franchise fee credits. The City will retain the right to conduct financial audits at least once a year. The franchise fee will not apply to the telephone or Internet revenues.

F. Indemnification, Insurance and Security Fund

The franchise includes insurance and security fund requirements to protect the City from any losses it may incur in connection with WIN's performance of its franchise obligations.

G. Regulation of Rates and Charges

Federal law states that rates and charges of cable operators may not be regulated when they face effective competition, which will be the case when WIN begins operations. However the proposed franchise still requires WIN to provide the Office of Cable Communications with a list of all its rates and charges.

H. Low Income Discounts

WIN has agreed to provide discounts of 30 % off the cost of basic cable service to low- income seniors, the disabled and individuals living in subsidized housing. This is consistent with current AT&T practice, but is greater than the AT&T franchise requires.

I. General Use of and Construction in the Right of Way

The proposed franchise incorporates the City's standards and procedures for construction in the right of way. It requires a performance bond in the amount of $2 million to insure that WIN performs its construction according to City standards.

J. Construction Schedule

WIN must complete its buildout and offer services to all areas of the City within 7 years beginning in 2001. WIN has recently reached an agreement with Bechtel Corporation to provide project management services including engineering, procurement and construction. Bechtel is a major engineering, construction and project management company with 1999 revenues of $15.1 billion. WIN plans to build its system in phases, as shown on the attached map:

Phase 1: Downtown/Central Area
Phase 2: Georgetown/High Point
Phase 3: Capitol Hill/Madison Valley
Phase 4: Queen Anne and Magnolia
Phase 5: North of Ship Canal West of I-5
Phase 6: North of Ship Canal East of I-5

The WIN franchise requires that they complete construction of their system according to the following schedule:

End of Year 1: no requirement
End of Year 2: 10% complete
End of Year 3: 20% complete
End of Year 4: 40% complete

End of Year 5: 60% complete
End of Year 6: 80% complete
End of Year 7: 100% complete

K: Enforcement Mechanisms

The proposed franchise retains the ability of the City to use a number of available remedies to address a breach of the franchise terms. These include liquidated damages, which can be implemented in the event that WIN fails to meet its build out schedule or fails to comply with other provisions of the franchise that result in injury to the City. The City also retains the right to terminate the franchise for any material breach by WIN.

5. Effect of Granting Franchise

This section looks at the effect that granting of a franchise to WIN will have on the city and its residents and outlines the risks and benefits involved.

A. Enhanced Competition

WIN will provide real competition to the incumbent cable and wire line telephone providers, and real choice for their customers. While there are no guarantees that competition will result in lower prices and better customer service, we expect that robust competition among providers of broadband residential services will benefit Seattle consumers.

A report released by the Federal Communications Commission on January 17, 2000 stated the following regarding the effects of competition in communities served by competitive cable providers; "…the case studies suggest that subscribers have benefited from "head-to-head" competition. Generally, in the communities studied, subscribers: (a) paid lower monthly charges for services and equipment; (b) have received additional program offerings; (c) have access to alternative sources of telecommunications and Internet services; (d) have received new digital services; and (e) may expect better customer service from the incumbent cable operator."

B. Impacts of Infrastructure Deployment in the Right of Way

WIN will need to install a significant amount of infrastructure in the City's right of way to provide its broadband services. This includes cable together with hubs, nodes, power cabinets and residential terminals. WIN will be required to obtain a Master Pole Attachment Agreement from Seattle City Light and complete its aerial construction under the terms of that agreement. WIN will be required to participate in the Utility Construction Coordination process and adjust its construction in the downtown area to coincide with other planned construction. The Office of Cable Communications will work with WIN, Seattle City Light and SeaTrans to mitigate the impact that the deployment of this infrastructure will have on traffic, the condition of the right of way and the City's aesthetic quality.

C. Fiscal Impact

The City of Seattle will benefit from taxes and fees generated during construction and from operations. Most construction will be subject to the Sales Tax, of which the City General Fund receives 0.85 %. Franchise fees and taxes paid by WIN will depend on the amount of revenue it generates in Seattle. We expect that this total will increase significantly as WIN builds out its systems and acquires subscribers. While WIN will lure some customers away from the incumbent telecommunications providers, thus showing no net increase in revenues, it is possible that increased competition and new service offerings will increase the size of the total telecommunications market in Seattle and the revenues that will be subject to franchise fees and taxes. WIN cable revenues will be subject to a 10% Utility Tax and an adjusted Franchise fee of between 2.5 % and 3.5 % as established annually by the Seattle City Council. WIN telecommunications revenue (including Internet service) will be subject to the 6% Telecommunications Utilities Tax.

There may be increased costs to the City associated with administering this franchise. The deployment of additional infrastructure may require more staff to manage and document its existence, and handle citizen complaints. In addition to ensuring that WIN meets its franchise obligations the Office of Cable Communications will need to respond to citizen inquiries and customer service issues. These costs should be recovered through the permitting process and franchise fees.

The proposed franchise agreement will also result in a $545,000 technology grant to the City. This money will be provided to the City regardless of the success WIN has in attracting subscribers.

D. Public Benefits

In addition to the benefits competition will bring to telecommunications consumers such as new innovative services better customer service and competitive pricing, we believe that we have negotiated several significant public benefits. WIN has agreed to:

- low income discounts for seniors, the disabled and individuals living in subsidized housing of 30% off the basic cable rate;

- a per subscriber charge of between $.40 and $.50 to fund public access programming;

- provide the City, in installments, a technology grant of $545,000 to fund the purchase of capital equipment for government access programming;

- provide direct fiber connections to up to 15 remote City sites, such as community centers, to support the broadcast of government access video and the optical equipment necessary to transport signals over the fiber;

- provide free Internet service to up to 25 public sites designated by the City

- allow the City the right to purchase additional fiber at incremental costs. This includes an agreement to cooperate with the City to route fiber closer to schools and community centers;

- provide up to 13 analog channels and up to 8 digital channels for PEG programming; and

- if WIN converts 10 of the analog PEG channels to digital, the City retains 60 megahertz of bandwidth for public purposes.

E. Risks of Granting WIN a Franchise

The risks of granting a competitive franchise are minor compared with those for an exclusive franchise. Both of the current cable providers have substantial investments in Seattle, so customers will continue to be able to obtain cable services.

Among the risks associated with granting WIN a franchise are:

- There will be disruption to the City's right of way and some inconvenience to citizens. Fiber and coaxial cable will be installed, on poles and underground along with other attendant equipment such as power supply boxes and nodes. However, as a CLEC, WIN could obtain permits for this construction for telecommunications services without a cable franchise, although it would be unlikely to do so.

- There is the real possibility that WIN may be unable to raise enough money to build the entire Seattle system or to operate a financially viable system after construction.

- WIN may be unable to provide the services described in their franchise application.

6. Conclusions and Recommendations

The Office of Cable Communications believes that WIN should be given an opportunity to compete in Seattle against AT&T and Millennium Digital Media because this competition is in the best interests of the City and its residents. In formulating this recommendation, OCC considered the balance between the risks and benefits outlined above and concluded that the benefits to be gained by granting WIN a franchise to construct and operate its broadband system in Seattle far outweigh the risks involved.

The question then becomes whether the City has developed sufficient safeguards in its franchise agreement to mitigate against those risks and to protect the interests of the City. We believe the following provisions of the proposed franchise agreement affords the City such protections:

- The franchise includes indemnification and insurance provisions and security fund requirements to protect the City from any losses it may incur in connection with WIN's performance of its franchise obligations.

- The franchise contains a list of franchise breaches that will result in liquidated damages and the City retains the right to terminate the franchise for cause.

- The proposed franchise incorporates the City's standards and procedures for construction in the right of way. It requires a $2 million performance bond to insure that WIN performs its construction according to City standards.

Staff from DoIT, SEATRAN and City Light will soon brief Council on efforts to minimize disruption to the right of way and inconvenience to Seattle residents and to reduce the aesthetic impact to the City caused by the deployment of WIN's infrastructure.